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May 8, 1998

Ms. Cynthia L. Johnson
Director, Cash Management Policy and Planning Division
Financial Management Service
U.S. Department of the Treasury
Room 420
401 14th Street, SW
Washington, DC 20227

RE: **Federal Government Participation in the Automated Clearing House System RIN 1510-AA39**

Dear Ms. Johnson:

The Independent Bankers Association of America (IBAA) is pleased to comment on the Financial Management Service (FMS) proposal governing Federal agency use of the Automated Clearing House (ACH) system and the reclamation of benefit payments. IBAA represents 5,500 independent community banks nationwide with more than 15,000 locations that hold nearly $375 billion in insured deposits, $445 billion in assets, and more than $240 billion in loans for consumers, small businesses and farms in the communities they serve. IBAA members also employ more than 200,000 people in their communities.

The proposal would extensively modify *31 CFR part 210* which defines the rights and liabilities of the Federal government, financial institutions, receivers and originators with regard to the ACH system to more closely parallel private sector ACH Operating Rules promulgated by the National Automated Clearing House Association (NACHA). The proposal also clarifies and modifies provisions governing the reclamation of benefit payments.

IBAA Position

The IBAA supports FMS efforts to provide a regulatory framework for Federal government use of the ACH system that more closely parallels the ACH Operating Rules. The proposal is structured on the premise that Federal agencies are subject to all of the obligations and liabilities imposed on originating and receiving banks under the ACH Operating Rules except as otherwise provided in the proposed regulations.

We appreciate FMS efforts to clarify its regulations governing the reclamation of benefit payments. Unfortunately, the extremely onerous reclamation regulations and procedures, including the criteria which a receiving bank must meet in order to limit its liability, remain in place. IBAA strongly urges FMS to convene work group, including the IBAA and other financial industry trade associations and Federal agencies, to address the myriad of outstanding

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concerns related to reclamations. The work group's final output would be a regulatory framework that is workable for the banking industry and Federal agencies. This framework would then become the basis for a new rulemaking process governing reclamations. IBAA believes that the problematic aspects of reclamations may thwart FMS efforts to convert payments from paper to electronics if the issues remain outstanding.

The IBAA's specific comments on various aspects of the proposed rule follow.

Complete Rule Preemptions
The proposed regulation completely preempts ACH Operating Rules in three areas: reclamation of benefit payments, compensation and arbitration, and timing of origination.

Reclamations
As noted earlier, Federal benefit payments to deceased or legally incapacitated recipients would not be subject to the reclamation provisions of the ACH Operating Rules. The proposal does modify the current reclamation provisions to clarify the obligations and liabilities imposed on financial institutions and to provide a framework for paperless processing of reclamations.

Under existing regulations, a receiving bank is presumed liable for all benefit payments received after the death or legal incapacity of the recipient or death of the beneficiary unless the receiving bank meets the limited liability qualifications. A receiving bank has no right to limit its liability once it knows of the death or incapacity of the recipient or death of the beneficiary.

Time Frame for Initiating Reclamations: The proposal shortens the time period in which a Federal agency must initiate a reclamation after learning of the death or incapacity of the recipient or death of the beneficiary from 12 months to 120 days. IBAA strongly supports the proposed shortened time frame as it would increase the likelihood that the amount being reclaimed would be available to the agency initiating the reclamation, and thereby reduce the receiving bank's liability.

Six-Year Limitation: The proposal establishes a six-year limitation (based on the most recent six years of payments) on a receiving bank's liability for post-death and post-incapacity payments. Under the proposal, if the amount in the account at the time the receiving bank receives notice of the reclamation exceeds the six-year amount, the receiving bank would be liable for the full amount in the account. For example, if the payments had been made for twenty years following the death of the recipient and the amount in the account was equal to or exceeded the total amount of the payments made during the twenty years, the receiving bank would be liable for the full amount of all payments made over the twenty-year period. However, if the amount in the account when the receiving bank received the reclamation notice was equal to the most recent ten years of payments, -- less than the full twenty, but more than the six-year amount, -- the receiving bank would be liable for the most recent ten years of payments.

IBAA supports FMS efforts to limit a receiving bank's liability. However, we believe that the proposed six-year limitation is still too long as it continues to subject receiving banks to substantial and unreasonable liability. We believe that an 18-month limitation is more reasonable. In the event that funds have been withdrawn from the recipient's account, an 18-month limitation would greatly increase the likelihood of the receiving bank and/or the Federal agency collecting the withdrawn funds. This time frame would closely parallel the time for check reclamation.

Amount in the Account

The "amount in the account" definition currently includes the balance in the account when the receiving bank receives a notice of reclamation, and any deposits/credits made prior to the receiving bank remitting funds. The proposal modifies the definition to include debit card withdrawals, automated withdrawals, forged checks or comparable instruments honored after the receiving bank has knowledge of the death or incapacity of the recipient or death of the beneficiary. Current regulations allow the receiving bank "reasonable time"(not later than the close of business on the day following receipt of the reclamation notice) to place a hold on the account. The proposed revisions would eliminate this "reasonable time" provision. Therefore, under the proposal, the elimination of the "reasonable time provision" and the revised "amount in the account" definition would increase the receiving bank's liability to include any withdrawals after the receiving bank has received notice and before it has the opportunity to place a hold on the account.

Under the proposed revision, a receiving bank would need to take immediate steps to freeze account funds upon receipt of a reclamation notice. This would be problematic in today's ATM and point-of-sale networks. IBAA understands that approximately one half of community banks maintain "on-line" host links to their ATM and point-of-sale networks. These banks would be able to electronically place a hold on an account that would take effect immediately. However, we also understand that the remaining community banks utilize "batch processing" systems. In a batch processing environment, a hold would be activated during the daily update (typically ranging from early evening to early morning of the next day). Community banks operating in batch processing environments would not have the opportunity to immediately freeze account funds and would substantially increase their liability under the proposed revision. We strongly recommend that the FMS allow financial institutions that operate in this batch environment the ability to exclude debit or ATM card transactions at ATMs and point-of-sale terminals. Community banks would incur their greatest exposure from signature-based debit card transactions as there is no limit on the amount of the transaction.

Compensation and Arbitration

The ACH Operating rules governing compensation allow for the settlement of claims between ACH system participants. The rules apply regardless of the original or ultimate beneficiary of any entry. The ACH Operating Rules also provide for arbitration of disputes between ACH system participants. The proposal would exempt Federal agencies from the NACHA compensation and arbitration process. While we understand that the NACHA compensation and arbitration process would be problematic for the Federal government, we believe receiving banks should have some process for redress in settling disputes with Federal agencies short of resorting to the courts.

Timing of Origination
The proposal preempts an ACH Operating Rule provision that requires a credit entry be originated no more than two banking days before the entry settlement date, therefore, the proposal permits Federal government entries to be originated earlier than two banking days before settlement. It is IBAA's understanding that this two-day provision is in place to control the risk associated with the originator's inability to fund transactions. Given that Federal ACH transactions are originated by a federal agency and backed by the full faith of the U.S. Government, we support the proposed preemption.

Partial Rule Preemptions

Verification of Recipient Identity
ACH Operating Rules assign responsibility for "properly" authorized transactions and liability for unauthorized transactions to the originating bank. The proposed regulations would assign liability for forged authorizations to the receiving bank. We agree that the proposed provision establishing receiving bank liability for unauthorized transactions is reasonable as it parallels statutory provisions governing private sector transactions. However, it is unfair for the receiving bank to be liable for "improper" authorizations in instances where Federal agencies obtain authorizations. We urge the FMS to exempt the receiving bank from liability resulting from a forged authorization in instances where the Federal agency accepted and processed the authorization. IBAA also recommends that the FMS permit a receiving bank's liability for fraudulent authorizations to end 10 business days after the Federal government receives notification from the receiving bank.

Prenotifications
The proposed rule would require a financial institution that receives a prenotification related to a Federal government ACH entry to verify the account number **and** at least one other identifying data element. The name of the recipient could be used as an additional identifying data element. This requirement supersedes the ACH Operating Rules which permit a financial institution to rely solely on the account number in posting transactions to an account. The proposed rule would also require Federal agencies to originate a prenotification before initiating a debit entry to a recipient's account. Prenotifications could be received in any ACH file on any day with live entries or zero dollar entries. Prenotifications would be optional for Federal government ACH credit entries. Under the ACH Operating Rules, prenotifications are optional for all ACH entries.

The IBAA opposes this proposed provision as such a requirement would be extremely onerous since it could only be accomplished through manual intervention. Manual intervention would substantially increase receiving banks' processing costs without providing any commensurate benefit. The proposed requirement is also inconsistent with *Uniform Commercial Code Article 4A* in that *Article 4A* permits a receiving bank to rely solely on the account number for posting an ACH corporate credit transaction.

Termination and Revocation of Authorizations

If the receiving bank closes a recipient's account, the receiving bank **must** provide thirty calendar days' written notice to the recipient prior to closing the account, except in the case of fraud. According to the FMS commentary, this provision would protect recipients from being deprived of timely access to their accounts and allow sufficient time to make other arrangement to receive the funds.

The IBAA opposes this proposed provision. We believe this proposed requirement is unreasonable and without merit. It is totally inappropriate for the FMS to attempt to prescribe policies governing a financial institution's account relationship with its customer. Banks of all sizes routinely close accounts due to unsatisfactory performance (typically excessive overdrafts) or in instances of fraud. Banks provide notification to the account holder; however, terms of the notification are determined by the financial institution. IBAA urges the FMS to be mindful that receiving banks are **NOT** acting as Treasury's financial agents in receiving federal government ACH transactions. Therefore, the Treasury does not have the authority to establish policies governing a financial institution's account relationship with its customer. Such a notification requirement would also require banks to establish a separate account closing process for accounts receiving Federal ACH transactions.

Federal Government Adoption of Future Rule Changes

The proposed framework for governing Federal government use of the ACH network is based on ACH Operating Rules in effect as of September 19, 1997. Future amendments to the ACH Operating Rules would not apply to Federal government entries unless the Treasury expressly accepts the amendments by publishing notice of acceptance in the *Federal Register*. In addition, if the Treasury accepts the amendment, it would also determine the amendment's effective date. The IBAA urges that the final rule specify that all ACH Operation Rules amendments apply to Federal agencies, unless FMS issues a public notice stating its decision to preempt or modify the change at least 30 days prior to the effective date of the ACH Operating Rules amendment. We also urge FMS to notify each financial institution of decisions to preempt or modify ACH Operating Rules amendments. Express notification would eliminate the potential for any confusion regarding the applicability of ACH Operating Rules amendments.

Vendor Payments

The FMS is also seeking comment regarding the reason for the limited success of financial electronic data interchange (FEDI) in conjunction with ACH payment to vendor doing business with the federal government. Currently, the majority of community banks do not have the capability to translate financial electronic data interchange (FEDI). This limited capability is due to insufficient customer demand for FEDI. In addition, prior to requirements of EFT '99, community banks could not make a compelling business case for purchasing FEDI software.

In response to requests from the IBAA and the Treasury, the Federal Reserve System is in the process of developing a low cost FEDI software solution via Fedline which will be available in the third quarter of 1998. In addition, a recent ACH Operating Rules amendment requires that financial institutions provide remittance information to customers upon customer request. We believe that the Federal Reserve's product offering coupled with the ACH Operating Rules amendment will substantially pave the way for community banks to provide FEDI translation services to their customers.

Automated Enrollments

IBAA supported NACHA's proposal to expand the use of the Automated Enrollment process to include both consumers and corporations receiving debits and credits from the Federal government. Those IBAA member banks currently using the Automated Enrollment process report a good experience thus far, indicating that the elimination of paper and the cost savings realized, are just a few of the benefits of the program. The expanded use of the Automated Enrollment process further facilitates the use of the ACH network and increases the opportunities for community banks to serve their customers more efficiently.

Conclusion

The IBAA is generally supportive of FMS efforts to more closely parallel the Federal government ACH regulations with private sector ACH rules. However, we do have concerns about various aspects of the proposed amendments particularly those regarding the reclamation process, prenotifications and account closings. We strongly urge the FMS to adopt the recommendations specified above. We further urge the FMS to remain mindful that the rules governing the rights, responsibilities of financial institutions must be reasonable and within the operational capabilities of financial institutions.

The IBAA appreciates the opportunity to comment on the proposed rule.

Sincerely,

William L. McQuillan
President

IBAA, ACH